competition in the provision of new types of advanced services.[383] Advanced services technologies and markets are still emerging and developing. To maintain the growth of this nascent industry, we must continue to ensure competition in the provision of advanced services. Therefore, we scrutinize carefully the possibility of an increase in incentive and ability to discriminate against competitive providers of such services.[384] The information gleaned from this scrutiny informs the Commission, furthers its' efforts to encourage innovation and investment in advanced services,[385] and comports with the Commission's obligations under section 706 to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans."[386]

175. As in the SBC-Ameritech merger proceeding, we are concerned with the effects of discrimination on competition in the provision of interexchange services and local exchange services.[387] Specifically, we conclude that the combined entity likely will discriminate to a greater extent against termination of interexchange calls by competing providers in the combined region, as well as against competitive LECs seeking to provide local exchange services in the combined region.[388] With respect to local exchange competition, we believe that the likelihood of increased harmful discrimination is particularly acute with respect to competitive providers of local exchange services to mass market customers (smaller businesses and residential customers).[389]

176. Incumbent LECs in general have both the incentive and ability to discriminate against competitors in incumbent LECs' retail markets. This incentive exists in all retail markets in which they participate. Incumbent LECs' ability to discriminate against retail rivals stems from their monopoly control over key inputs that rivals need in order to offer retail services.

177. In many cases, discriminatory conduct by an incumbent LEC in its region affects competitors in areas both inside and outside the incumbent's region. The resulting effects on competitors, externalities or "spillover" effects,[390] can directly or indirectly harm customers, whose business the incumbent LEC is seeking to gain. Spillover effects directly harm customers

[383] *SBC/Ameritech Order,* 14 FCC Rcd at 14795, para. 187.

[384] *Id.* at 14796, para. 187.

[385] *Id.* at 14796, para. 187, n.348.

[386] *See* Pub.L. 104-104, Title VII, § 706, Feb. 8, 1996, 110 Stat. 153, reproduced in the notes under 47 U.S.C. § 157.

[387] *See SBC/Ameritech Order,* 14 FCC Rcd at 14796, para. 188.

[388] *Id.*

[389] *Id.*

[390] Externalities, or spillovers, arise when an action by one party imposes costs or benefits on another party or parties. *See* Robert S. Pindyck & Daniel L. Rubinfeld, *Microeconomics* (Prentice Hall, 4th ed. 1998) at 648. A classic example of a negative externality is air pollution.

when the incumbent LEC's discrimination in one region negatively affects a customer's communications between that region and another region.[391] Spillover effects indirectly harm customers when an incumbent LEC's discrimination in one region increases a national rival's general costs, thereby indirectly impairing the ability of this rival to provide service to customers in other regions.[392] Regardless of the nature of the spillover effects, the intended result is to reduce the ability of competitors to acquire and/or keep customers.[393]

178. Because after the merger the larger combined entity would realize more of the gains from such external effects, the marginal benefit and corresponding incentive to discriminate in each area would increase.[394] As a result, the level of discrimination engaged in by the combined entity in each region within the combined territory would be greater than the sum of the level of discrimination engaged in by the two individual companies in their own, separate regions, absent the merger.[395] Specifically, the combined entity will be better able to discriminate against competitors by coordinating its formerly separate local exchange operations and controlling both ends of a higher percentage of calls, which is relevant to the provision of interexchange services.[396] As described above, regulators will have greater difficulty monitoring and detecting this misconduct because of the reduction in the number of benchmarks.[397] Therefore, the combined company not only will have more incentive to discriminate against rivals, but also will have a heightened ability to inhibit competitors' provision of services within the combined region compared with the ability of each company currently to discriminate within its region.[398] We explain below why the combined entity is likely to increase the level of discrimination that rivals must overcome to provide retail advanced services, interexchange services, and local exchange services.

2. Analysis

a. Advanced Services

179. Although the Commission issues rules to prevent discrimination, it is impossible for the Commission to foresee every possible type of discrimination, especially with evolving

---

[391] *See SBC/Ameritech Order*, 14 FCC Rcd at 14797-98, para. 192 (for a more detailed discussion of spillover effect).

[392] *See id.* at 14797, para. 192.

[393] *Id.* at 14798, para. 192.

[394] *Id.* at 14798, para. 193.

[395] *Id.*

[396] *Id.* at 14798, para. 194.

[397] *Id.*

[398] *Id.* at 14798-99, para. 194.

technologies.[399] Within the past year, the Commission has adopted rules, most notably the *UNE Remand Order*, and the *Line Sharing Order*, that should enhance competition by reducing the ability of an incumbent LEC to discriminate in the provision of advanced services.[400] It is too early for the Commission to discern the impact of these rules. Moreover, the advanced services market is still a nascent industry. Accordingly, we find that despite certain changes in the regulatory landscape, the increased discrimination theory we enunciated in the *SBC/Ameritech Order* still holds true today.[401]

(i) Background

180. One of the fundamental goals of the 1996 Act is to promote innovation and investment by all participants in the telecommunications marketplace, in order to stimulate competition for all services, including advanced services.[402] Today, both incumbent LECs and new entrants are developing and deploying innovative new technologies to meet the ever-increasing demand for high-speed, high-capacity advanced services. For the advanced services market to develop in a robust fashion, it is critical that the marketplace for these services be conducive to investment, innovation, and meeting the needs of consumers.[403] Moreover, we are required by section 706 to be particularly vigilant that a merger between two incumbent LECs such as Bell Atlantic and GTE will not harm the development of competition for such advanced services.[404]

(ii) Incentive and Ability to Discriminate

181. We find that incumbent LECs such as Bell Atlantic and GTE have ample ability and incentive to discriminate against advanced services providers, and that the increase in the

---

[399] *Id.* at 14804, para. 206.

[400] *See In the Matter of Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238 (rel. Nov. 5, 1999) (*Third Report and Order and Fourth FNPRM* or *UNE Remand Order)*; *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Docket Nos. 98-147 and 96-98, *Third Report and Order and Fourth Report and Order,* FCC 99-355 (rel. Dec. 9,1999) (*Line Sharing Order*). The *UNE Remand Order* specifies which network elements must be unbundled by incumbent LECs. For example, the order unbundles subloops and packet switching in limited circumstances. The *Line Sharing Order* requires incumbent LECs to unbundle the high frequency portion of the loop in certain circumstances.

[401] *See SBC/Ameritech Order,* 14 FCC Rcd at 14800-07, paras. 197-211.

[402] *See Advanced Services Further Notice*, 14 FCC Rcd at 4762, para. 1 and n.2 (citing Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong. 2d Sess. 1 (1996) (*Joint Explanatory Statement*)).

[403] *See Advanced Services Further Notice*, 14 FCC Rcd at 4762, para. 2.

[404] *See* Section 706 (a), 47 U.S.C. § 157 nt (a) (Stating that the Commission "shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans (including, in particular, elementary and secondary schools and classrooms) by utilizing, in a manner consistent with the public interest, convenience, and necessity, price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.").

incentive and ability to discriminate may frustrate substantially the realization of the 1996 Act's and the Commission's goals to encourage the deployment of advanced services. Specifically, we find that the combined entity will have an increased incentive and ability to discriminate against competitors providing retail services that rely on new technology, particularly advanced services like Sprint ION.[405] Because incumbent LECs either currently do, or in the future will, compete with other providers of advanced services, they have an incentive to discriminate against companies that depend on the incumbents' for evolving types of interconnection and access arrangements necessary to provide new services to consumers.[406] They also have the incentive to limit or control the development of new services, to the extent new services compete with their current offerings.[407] In addition, competitors often are totally dependent on incumbent LECs for last mile wireline access to end users.[408]

182. We note that in some cases, the incumbent's control over the loop may give it the ability to tailor the loop to any collocated or attached electronics, thereby forcing competitors to provide service identical to the incumbent's.[409] Specifically, by choosing electronics that meet the incumbent's market need, without regard to that of its competitors, the incumbent may stifle competitors' ability to innovate.[410] Discrimination against competitors wishing to innovate and deploy technology different than that deployed by the incumbent LEC often is not easily detected by regulators.[411]

(iii) Post-Merger Incentive and Ability to Discriminate

183. We find that the instant merger, like the SBC/Ameritech merger, increases the ability and incentive of the merged entity to discriminate against the providers of advanced

[405] Sprint Nov. 23, 1998 Petition at 34-36. Sprint's ION service integrates voice, internet, frame relay and other data traffic on one customer access facility and carries all of this traffic in asynchronous transfer mode (ATM) data format through the Sprint network. Sprint Brauer Aff. at 3. Sprint states that Sprint ION "will focus customers on the efficiency gained by integrating all services on one access facility, increased functionality provided to customers through increases in bandwidth, and innovations in customer control by providing the customer with easy-to-use service configuration functionality." *Id.* at 4.

[406] *SBC/Ameritech Order,* 14 FCC Rcd at 14802, para. 202.

[407] For example, Sprint is concerned not only by incumbent LECs' ability to discriminate against competitors or potential competitors by denying access to necessary inputs, but also by slow-rolling competitors in negotiations for such inputs. Sprint Nov. 23 Petition at 34-35. *See also SBC/Ameritech Order,* 14 FCC Rcd at 14802-05, paras. 202, 204 & n. 378.

[408] *SBC/Ameritech Order,* 14 FCC Rcd at 14802, para. 202. Sprint states that its ION service will reach customers through either a dedicated access line purchased by Sprint from an incumbent LEC (in most instances), through an xDSL loop and collocation space leased from an incumbent LEC or through resale. Sprint Brauer Aff. at 14

[409] *See SBC/Ameritech Order,* 14 FCC Rcd at 14804, para. 205.

[410] *Id.*

[411] *Id.*

services.[412] We agree with Sprint that there are spillover effects to discrimination against national providers of advanced services, and that, post-merger, the combined entity would internalize external effects to some extent, thus increasing its incentive to act in one area in a manner that produces these effects in another area.[413] Economies of scale and scope, and network effects imply that when incumbent LECs weaken a competitive service in one region, this weakens it in other regions as well.[414] For services with "multi-market dependence," discrimination in one market will have a ripple effect in other markets.[415] We are specifically concerned that the merger's large footprint will create more incentives for the merged entity to discriminate against competitors whose networks become more attractive with more customers.[416]

184. After the merger, the combined company will be able internalize these external effects of discriminatory conduct in one area in the combined region on another area in that region.[417] By capitalizing on its monopoly control over loops, for instance, the combined entity can discriminate against an advanced services provider entering an area in the combined region.[418] This will reduce the customer base and revenues of the advanced services provider, thereby reducing its ability to enter another region.[419] Because of the possibility of internalizing such spillover effects, the incentive for the combined entity to discriminate against competitors providing retail advanced services in particular areas within the combined region will be greater than the sum of the incentives for the companies operating alone.[420]

185. As we stated in the SBC/Ameritech proceeding, we are particularly concerned about discrimination in the advanced services market, given the Commission's obligations under section 706 to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans."[421] In the advanced services market, there is a continuing shift from a circuit switched to a packet switched environment, combined with the emergence of data LECs such as Rhythms and Covad, that are using advanced technologies to provide innovative new services.[422] Any discrimination against these competitors will likely

412 *Id.* at 14805, para. 207.

413 *See* Sprint Nov. 23, 1998 Petition at 29, 33-36.

414 *See SBC/Ameritech Order,* 14 FCC Rcd at 14805, para. 207, n. 384.

415 *Id.* at 14805, para. 207.

416 *Id.*

417 *Id.* at 14805, para. 208.

418 *Id.*

419 *Id.*

420 *Id.* at 14806, para. 208. *See also id.* at 14806-07; paras. 209-210 (for a more detailed discussion about the merged entity's increased incentive and ability to discriminate).

421 *Id.* at 14806-07, para. 210.

422 *Id.* at 14807, para. 210.

cause a significant setback to current and future efforts to encourage competition and innovation.[423]

b. Long Distance Services

186. In this section, we examine potential effects of the merger on the provision of interexchange services. Commenters allege that discrimination may take two forms: price and non-price. We examine these cases separately and conclude that the merged firm's increased incentive and ability to engage in non-price discrimination will harm competition in the provision of interexchange services, and, therefore, consumers of such services. With respect to price discrimination, specifically discrimination through a price squeeze, we conclude that there are adequate safeguards in place to guard against such conduct.

(i) Non-Price Discrimination

187. Bell Atlantic has satisfied the requirements of Section 271 in New York, and is offering long distance services to its customers there.[424] GTE has been in the long distance market since 1996. As Bell Atlantic is authorized to enter the long distance market in other states in its region, the merged entity will increasingly view interexchange carriers as retail competitors, not only as access customers.[425] This will give the merged firm incentives to deny, delay, or degrade access service to interexchange carrier competitors.[426] Because the merged entity will control more than one-third of all customers lines nationwide,[427] we must examine carefully the claim that the merged firm will gain an increased ability to harm its interexchange rivals.

(a) Incentive and Ability to Discriminate

188. For the reasons discussed below, we conclude that the merged entity has the incentive and ability to discriminate against competing interexchange carriers.[428] Specifically,

---

[423] *Id.*

[424] *See Bell Atlantic 271 Order.*

[425] *See SBC/Ameritech Order,* 14 FCC Rcd at 14808, para. 214.

[426] *Id.*

[427] *Trends in Telephone Service, March 2000,* Tables 20.1, 20.2 & 20.3, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission; Bell Atlantic/GTE May 22, 2000 *Ex Parte* Letter; Bell Atlantic 1999 Annual Report at 6. *See also* Letter from Michael Jones, Wilkie Farr & Gallagher, Counsel to Sprint, to Magalie Roman Salas, Secretary, FCC, (filed Apr. 12, 1999) (Sprint Apr. 12 *Ex Parte* Letter), Farrell & Mitchell attachment – Table 2 (citing Federal Communications Commission, *1997 Statistics of Communications Common Carriers,* Table 1.1); BlueStar, et al., Mar. 1, 2000 Joint Comments at 2 ("The proposed merger would create a gargantuan ILEC controlling over one-third of the nation's access lines.").

[428] *See SBC/Ameritech Order,* 14 FCC Rcd at 14808-09, para. 216. We note that GTE has not, in the context of this proceeding, been accused of any pattern of discrimination against rivals providing interexchange services. *But see* Sprint Brauer Aff. at 17-18 (citing GTE's continued billing of its own retail interLATA toll to Sprint's (continued....)

given their monopoly control over exchange access services, each Applicant currently has the ability to discriminate against rivals providing interexchange services, in favor of its own interexchange operations, by denying, degrading, or delaying access on the originating and terminating ends.[429] We focus our discussion on discrimination with respect to the potential for terminating access, because we find that the merged entity's incentive to engage in this type of discrimination will increase significantly as a result of the merger.

189. As we found in the *SBC/Ameritech Order*, recent developments in local networks have enhanced incumbents' ability to discriminate operationally and technically in favor of their long distance affiliates, in particular with respect to larger business customers.[430] The specific developments in the local network that have enhanced incumbents' ability to discriminate against rival interexchange providers that need different and generally more complex forms of network interconnection are: (1) the deployment of common channel signaling systems;[431] (2) the development of advanced intelligent networks (AIN), or software driven networks; and (3) further developments in multi-media applications (such as applications involving combinations of voice, data, image, and video traffic).[432] Incumbents may discriminate against interexchange carriers by, among other things: (1) refusing to provide interconnection at critical points in their intelligent network based on alleged harm to the network or refusing to convey certain types of control messages across the AIN; or (2) "slow rolling" their competitors who make requests for

(Continued from previous page)
California local end user subscribers). We find, however, that prior to the merger, GTE's incentive to engage in such behavior was minimal due to its insubstantial share of the long distance market, which dictated that any rewards GTE gleaned from such behavior would be slight. According to the *Trends in Telephone Service*, GTE has less than a 1% share of the long distance market. *Trends in Telephone Service, March 2000*, Table 11.2, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission.

[429] *See SBC/Ameritech Order*, 14 FCC Rcd at 14809, para. 217. The incentive to discriminate exists because, for calls originating in region, an incumbent LEC will be able to benefit from discrimination by securing more customers on the originating side. An incumbent LEC has the incentive to discriminate against termination of a particular call only to the extent that the call originated in the same incumbent's region. If an incumbent LEC providing terminating access to an interexchange carrier denies or degrades that access, then the incumbent LEC competing with the interexchange carrier at the originating end may also benefit. *Id.* at 14809, para. 216.

[430] *Id.* at 14809, para. 218, n.399.

[431] These systems are referred to as "out of band" signaling networks, and they simultaneously carry signaling messages for multiple calls. In general, most LECs' signaling networks adhere to a Bellcore standard Signaling System 7 (SS7) protocol. SS7 networks use signaling links to transmit routing messages between switches, and between switches and call-related databases (such as the Line Information Database, Toll Free Calling Database, and Advanced Intelligent Network databases). These links enable a switch to send queries via the SS7 network to call-related databases, which return customer information or instructions for call routing to the switch. A typical SS7 network includes a signaling link that transmits signaling information in packets, from a local switch to a signaling transfer point (STP), which is a high-capacity packet switch. The STP switches packets onto other links according to the address information contained in the packet. These additional links extend to other switches, databases, and STPs in the incumbent LECs' networks. A switch routing a call to another switch will initiate a series of signaling messages via signaling links through a STP to establish a call path on the voice network between the switches. *See Local Competition Order*, 11 FCC Rcd at 15738-41, paras 479-83.

[432] *See SBC/Ameritech Order*, 14 FCC Rcd at 14809-10, para. 219.

interconnection or technical information.[433]

190. We conclude that the ability for Bell Atlantic and GTE to discriminate will be greatest for customized or advanced interexchange access services for which detection of discrimination is most difficult.[434] Greater network complexity, a paucity of operational experience and objective performance benchmarks, and the possibility of new types of discrimination, increase the difficulty of detecting discrimination. In such a situation, past experience with the interconnection of plain vanilla, or POTS service, becomes increasingly less useful as a regulatory tool for preventing, detecting, and remedying discrimination.[435]

(b) Post-Merger Incentive and Ability to Discriminate

191. We agree with Sprint that, as a result of the merger, the combined entity will have a greater incentive to discriminate in providing termination of in-region calls than either individual company would have absent the merger.[436] After the merger, the combined entity can realize the benefits of discrimination against competing carriers on in-region calls on the terminating end, by making it more likely that a customer on the originating end would choose the combined entity for interexchange services.[437] End users will be less likely to choose a competing carrier at the originating end whose service does not appear as good as the incumbent's service that is free from terminating problems.

192. We therefore agree with parties arguing that, with respect to interexchange calls, the merged firm will have an increased incentive to discriminate in terminating the calls of competing interexchange carriers, stemming from the fact that benefits will flow from controlling both ends of a higher percentage of interexchange calls.[438] According to Sprint, the combined Bell Atlantic/GTE entity would terminate 43 percent of minutes that the combined entity controls on the originating end, a 20 percent increase from the 36 percent weighted average of minutes controlled cumulatively by the companies.[439] Applicants assert that this increase "is no greater an increase than in the SBC/[Pacific] Telesis merger, where the

[433] *Id.* at 14810, para. 219.

[434] *See id.* at 14810, para. 220.

[435] *Id.*

[436] *See* Sprint Nov. 23, 1998 Petition at 33. An incentive to discriminate on the originating end is not a significant issue in this proceeding because there will always be an incentive for an incumbent offering interexchange services to discriminate against traffic originating in its region, and this merger will not create a greater incentive. *See SBC/Ameritech Order,* 14 FCC Rcd at 14812, n.419.

[437] *See SBC/Ameritech Order,* 14 FCC Rcd at 14812, para. 225.

[438] *See* AT&T Mar. 1, 2000 Comments at 17, n.8; Sprint Nov. 23, 1998 Petition at 31-36; *see also* MCI WorldCom Nov. 23, 1998 Comments at 38.

[439] *See* Sprint Nov. 23, 1998 Petition at 33.

Commission found that an increase of 'only six to seven percentage points' did not pose any anticompetitive risk."[440] As we stated in the *SBC/Ameritech Order*, the Commission reached a different conclusion in the *SBC/Pacific Telesis Order,* where it stated that there was no anticompetitive risk from the increase in the percentage of minutes for which the combined entity would control both the originating and terminating end.[441] Here, the harm would be significant because of the substantial number of customers that will be affected by the discrimination made possible by the increase in the percentage of interLATA traffic originating and terminating in Bell Atlantic's and GTE's regions.[442] We therefore agree with MCI WorldCom that, because interexchange carriers would be more dependent on a single entity for exchange access than they would absent the merger, hard-to-detect methods of non-price discrimination would be even more crippling to competing long distance companies.[443]

193. We further agree with MCI WorldCom that the ability to engage in less detectable and more significant non-price discrimination would be greatly enhanced by the merger.[444] For the same reasons discussed above with respect to advanced services, we conclude that, as a result of the merger, the ability to discriminate against rivals in the termination of interexchange calls will be enhanced.

194. We recognize that the Commission concluded in the *Bell Atlantic/NYNEX Order* that given existing safeguards, the merger between Bell Atlantic and NYNEX would not result in an increased incentive and ability to engage in non-price discrimination against long distance competitors.[445] We note, however, that in the *Bell Atlantic/NYNEX Order*, the Commission did not specifically address the issue of discrimination on the terminating end of long distance calls, an issue that is significant here. We find that the larger scale of the instant merger as compared to that merger, however, increases the risks of non-price discrimination.[446]

---

[440] *See* Bell Atlantic/GTE Oct. 2, 1998 Application at 46 (quoting *SBC/PacTel Order,* 12 FCC Rcd at 2647, paras. 46,53,57).

[441] *See SBC/Ameritech Order,* 14 FCC Rcd at 14812-13, para. 226, n.423 (stating that "[t]he result in the *SBC/PacTel Order* was correct, however, because in that merger, any resulting harm from that increase in percentage points would not, in and of itself, have been fatal to the merger.").

[442] *See id.* at 14812-13, para. 226, n.424. In the SBC/Ameritech merger, we reached the same conclusion and agreed with Sprint that "the combined entity would terminate 45 percent of minutes that the combined entity controls on the originating end, a 50 percent increase from the 30 percent of minutes for which Ameritech currently controls both the originating and terminating ends." *Id.* at para. 226, n.420.

[443] *See* MCI WorldCom Nov. 23, 1998 Comments at 38 (asserting that common ownership facilitates Bell Atlantic's and GTE's ability to focus their non-price discrimination efforts across their regions); *see also SBC/Ameritech Order,* 14 FCC Rcd at 14813, para. 226, n.425.

[444] *See* MCI WorldCom Nov. 23, 1998 Comments at 38.

[445] *SBC/Ameritech Order,* 14 FCC Rcd at 14813, para. 228.

[446] At the time of the Bell Atlantic/NYNEX merger, the two firms controlled about 24% of customer lines nationwide, while the merged Bell Atlantic/GTE entity will control more than 33% of customer lines nationwide. *See 1997/1998 Statistics of Communications Common Carriers*, Tables 2.3 & 2.10, Federal Communications (continued....)

195. This merger, like the SBC/Ameritech merger before it, continues a trend of coalescing large incumbent LECs, and reversing the breakup of the Bell System. The old Bell system, with its large footprint, made it difficult for rivals to obtain access to necessary inputs, thus prompting its ultimate breakup.[447] This merger brings GTE into the old Bell footprint for the first time, and will result in a large footprint that would take another big step toward recreating the Bell System, whose discrimination against interexchange carriers led to divestiture in the first place.[448]

(ii) Price Discrimination (Price Squeeze)

196. In addition to non-price discrimination, opponents of the proposed merger have raised arguments about a particular form of strategic pricing involving the Applicants' leveraging monopoly control over bottleneck local loop facilities to inhibit competition from long distance rivals. For example, MCI WorldCom argues that once the combined entity begins selling in-region long distance service through an interexchange affiliate, it will take advantage of the "high" prices for interstate exchange access services (above cost prices), over which it has monopoly power (albeit constrained by regulation), by offering "low" prices for retail long distance services in competition with the other long distance carriers, thereby setting up a price squeeze.[449] Because interstate exchange access services are a necessary input for long distance services, opponents argue that the relationship between the combined entity's "high" exchange

(Continued from previous page)

Commission; *Trends in Telephone Service, March 2000,* Tables 20.1, 20.2 & 20.3, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission; Bell Atlantic/GTE May 22, 2000 *Ex Parte* Letter; Bell Atlantic 1999 Annual Report at 6. Non-price discrimination is a violation of several provisions of the Communications Act, as well as a number of rules adopted by the Commission. Section 272(c) of the Communications Act states that a BOC, in dealing with its long distance affiliate: (1) may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards; and (2) shall account for all transactions with an affiliate described in subsection (a) of this section in accordance with accounting principles designated or approved by the Commission. 47 U.S.C. § 272(c). We have adopted a number of rules implementing these provisions and otherwise designed to prevent non-price discrimination. *See* 47 C.F.R. §§ 53.200, et seq. *See also Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, Report and Order,* 11 FCC Rcd 17539 (1996) (*Accounting Safeguards Order*); *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, First Report and Order and Further Notice of Proposed Rulemaking,* 11 FCC Rcd 21905 (1996) (*Non-Accounting Safeguards Order*); *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61,* 12 FCC Rcd 15756 (1997) (*LEC In-Region, Interexchange Order*).

[447] *See SBC/Ameritech Order,* 14 FCC Rcd at 14814, para. 229.

[448] *Id.*

[449] *See* MCI WorldCom Nov. 23, 1998 Comments at 36-38. A price squeeze, as opponents use the term, refers to a particular, well-defined strategy of predation that would involve the combined entity setting high prices for access services while charging relatively low prices for retail services. It is this relationship between the input prices and the affiliate's prices, and not the absolute levels of those prices, that defines a price squeeze. *See SBC/Ameritech Order,* 14 FCC Rcd at 14815, para. 231, n.429; *Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20044, para. 116.

access prices and its affiliate's "low" prices for long distance services forces competing long distance carriers either to lose money or to lose customers even if they are more efficient than the combined entity's long distance affiliate at providing long distance services.[450] For the reasons discussed below, we conclude that price squeeze tactics are likely to fail under the circumstances presented here.

197. We conclude that because Bell Atlantic and GTE, either currently, or, in the future will, compete with interexchange carriers for the provision of interexchange services, the merged entity has the incentive to discriminate against these carriers through a price squeeze.[451] We also conclude that the combined entity will have a greater incentive to discriminate against the termination of calls through a price squeeze than either individual company would have absent the merger.[452]

198. We find, however, that, given the existing regulatory safeguards, the merged entity does not have significant ability to act on this incentive.[453] Although we do not wish to rely on regulatory safeguards to prevent potential public interest harms, we note here that certain safeguards mitigate against harms in this circumstance. In the *Access Charge Reform Order*, the Commission addressed the contention that an incumbent's interexchange affiliate could implement a price squeeze once the incumbent began offering in-region, interexchange toll services, and concluded that, although an incumbent LEC's control of exchange and exchange access facilities may give it the incentive and ability to engage in a price squeeze, the Commission has in place adequate safeguards against such conduct.[454] The Commission determined in that order that the existence of price caps reduces the ability to raise prices on access.[455] We also note that, because it is relatively easy to compare an incumbent LEC's access

---

[450] We note that access charges already are above cost. Therefore, in order to implement a price squeeze, an incumbent need only offer low prices for its long distance services. *SBC/Ameritech Order,* 14 FCC Rcd at 14815, para. 231, n.430.

[451] *See SBC/Ameritech Order,* 14 FCC Rcd at 14815, para. 232.

[452] *See id.* at 14815-16, para. 232.

[453] We reached the same conclusion in both the *Bell Atlantic/NYNEX Order and the SBC/Ameritech Order. See Bell Atlantic/NYNEX Order* at 20045, para. 117. *See also SBC/Ameritech Order,* 14 FCC Rcd at 14816, para. 233.

[454] *Access Charge Reform Order,* 12 FCC Rcd at 16100-04, paras. 275-282. For example, the Commission noted that the prohibition on joint ownership of switching and transmission facilities reduces the risk of improper allocations of the costs of common facilities between the incumbent and its interexchange affiliate, and helps deter any discrimination in access to the incumbent's transmission and switching facilities by requiring the affiliates to follow the same procedures as competing carriers to obtain access to those facilities. *See id.* at 16102, para. 279 (citing *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21982-84, paras. 159-162). The Commission also noted that the requirement that an incumbent LEC offer services at tariffed rates, or on the same basis as requesting carriers that have negotiated interconnection agreements pursuant to section 251, reduces the risk of a price squeeze to the extent that an affiliate's long distance prices would have to exceed its costs for tariffed services. *See Access Charge Reform Order*, 12 FCC Rcd at 16102, para. 279.

[455] *Id.* at 15993-94, para. 26 (stating that "price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.") Price caps fundamentally alter the process by which (continued....)

charges with its own retail prices, price discrimination is relatively easy for the Commission and others to detect, and therefore, is unlikely to occur.[456] Moreover, important non-regulatory safeguards exist. For example, as the Commission noted in the *AT&T/TCI Order*, the presence of extensive sunk facilities in both the local and interexchange markets suggests that the merged firm would be unable to successfully raise prices if any competitors were driven out of the market by the price squeeze.[457] Thus, because existing regulatory and non-regulatory safeguards greatly reduce the ability of incumbent LECs, to engage in a price squeeze, we conclude that there is no substantial probable public interest harm resulting from the increased incentive that Bell Atlantic and GTE may have to discriminate against the termination of calls through a price squeeze as a result of the merger.

c. Circuit-Switched Local Exchange Services

199. For the reasons discussed below, we conclude that the merger will increase the combined entity's incentive and ability to discriminate against competitive LECs seeking to provide local exchange services in the combined region. We believe that this increased discrimination particularly will be aimed at, and harmful to, competitive providers of local exchange services to mass market customers (smaller businesses and residential customers).[458]

200. We also note that the local exchange market is just that, a *local* market. For the most part, companies competing with the incumbent LEC in the provision of retail local exchange service compete on a local basis, and focus on a particular area or region.[459] For other competitive LECs, however, competing for local exchange service transcends local areas and takes a more national scope.[460] For such nationally competitive LECs, reputation, scale and scope, and technology are significant for their national strategy; a company's reputation in one region may affect its reputation in another region, and experience it gains with a new technology in one region may help it in another region.[461] It is this group of local exchange service competitors with a national scope, with which we are especially concerned.[462]

(Continued from previous page)
incumbent LECs determine the revenues they are permitted to obtain from interstate access charges for access services.

[456] *SBC/Ameritech Order,* 14 FCC Rcd at 14816-17, para. 234, n. 436.

[457] *See AT&T/TCI Order*, 14 FCC Rcd at 3215-16, para. 118.

[458] *See* MCI WorldCom Nov. 23, 1998 Comments at 29. *See also SBC/Ameritech Order,* 14 FCC Rcd at 14817, para. 236 (noting that competitive LECs providing local services to larger business customers may still be discriminated against, but that these LEC generally have more experience negotiating with incumbent LECs).

[459] *SBC/Ameritech Order,* 14 FCC Rcd at 14817, para. 237.

[460] *See id.*

[461] *See id.*

[462] For example RCN Corporation is currently operating in, or has begun building in, seven of the top ten US cities as measured by population density – Boston, New York, Philadelphia, Washington, DC, San Francisco, Los Angeles, and Chicago. *RCN Press Release – May 1, 2000.*

(i) Incentive and Ability to Discriminate

201. Because incumbent LECs compete with competitive LECs for the provision of retail local exchange services, incumbent LECs have the incentive to discriminate against competitive LECs that depend on the incumbents' inputs (such as interconnection and UNEs) to compete.[463] We find that a discriminatory interconnection policy will be profitable for an incumbent LEC insofar as its revenue gains in the provision of retail local exchange services exceed whatever revenues it forgoes from wholesale interconnection with rivals.[464]

202. Incumbent LECs' control over access to interconnection and other essential inputs gives them the ability to discriminate against rivals providing local exchange services. According to Sprint, incumbent LECs can discriminate against rival local carriers either by raising the price of interconnection charged to rivals (price discrimination) or by impairing their access to interconnection and other essential inputs.[465] We agree with Sprint that, because interconnection prices are subject to regulatory oversight, an incumbent's ability successfully to engage in price discrimination against competitive LECs seeking to enter its region is significantly weaker than its ability successfully to engage in non-price discrimination.[466] As evidence of incumbents' ability to engage in non-price discrimination against rival competitive LECs, MCI WorldCom asserts, for example, that Bell Atlantic has failed to comply with conditions imposed by the Commission in connection with the BA/NYNEX merger;[467] and that Bell Atlantic and GTE have: (1) failed to meet their obligations under section 251 to provide unbundled access to xDSL-capable loops and collocation on reasonable and nondiscriminatory terms;[468] and (2) generally been "effective and obdurate" foes of local competition.[469]

203. Discrimination against competitive providers of local exchange services is more likely to occur in conjunction with services to mass market customers as opposed to larger business customers, because competitors serving larger business customers generally possess more experience dealing with incumbents for provision of such services.[470] Moreover, competitive providers to business customers are better able to absorb the costs imposed by non-price discrimination, because they have a greater profit margin than providers to mass market

[463] *See SBC/Ameritech Order,* 14 FCC Rcd at 14818, para. 238.

[464] *See id.*

[465] *See* Sprint Nov. 23, 1998 Petition at 25.

[466] *See id.*

[467] *See* MCI WorldCom Mar. 1, 2000 Comments at 2.

[468] *See id.*

[469] *See id.*

[470] *See SBC/Ameritech Order,* 14 FCC Rcd at 14819, para. 240. We note that this is changing in some areas, such as New York and Texas, where there is increasing residential entry via the unbundled network element platform (UNE-P), a combination of the loop, transport and switching.

customers.[471] In addition, because competitive LECs have little experience in successful provision of local exchange services to mass market customers, there exist few examples of incumbent LECs' best practices in provisioning inputs for competitive LECs to use for serving mass market customers that could be used as benchmarks to detect discriminatory and unreasonable behavior.[472]

204. It is important to recognize, however, that to serve both mass-market customers and larger businesses, competing local exchange carriers need access to inputs necessary to terminate local calls in the incumbent's network.[473] Just as we determined that incumbents may deny or delay access to such inputs for competitors' provision of interexchange services, they may also do so for competitors' provision of local exchange services to all types of customers.[474] This type of discrimination is subtle and not readily detectable.[475]

(ii) Post-Merger Incentive and Ability to Discriminate

205. As we found in the context of retail advanced services and interexchange services, there are external effects to discrimination in the provision of retail local exchange services on a multi-region basis. The merged entity, with a larger local footprint, would realize more of the gains from such external effects, thus increasing its incentive to act in a discriminatory manner in one area, to produce these effects in another.[476] For national competitive LECs, such as large interexchange carriers, that plan to offer local service on a large scale in numerous major regions, entry into various areas likely will entail common research, product development, and marketing costs that must be covered by the sum of the competitive LEC's area-specific profits.[477] For such national carriers, the discrimination practiced in one region may impair the competitor's national or multi-regional plans, by increasing the competitor's costs and rendering it unable to compete as effectively or comprehensively as it would absent the discrimination.[478] Therefore, actions that decrease the profitability of the competitive LEC in one area may make it forgo entry into

---

[471] For example, if the cost of non-price discrimination to competitive providers is $5.00 per customer, it is easier to pass that cost along to business customers than mass-market customers. The $5.00 represents a much greater portion of a typical mass-market customer's bill than it does of a typical business customer's bill.

[472] *See SBC/Ameritech Order*, 14 FCC Rcd at 14819, para. 240.

[473] *See id.* at 14819, para. 241.

[474] *See id.* The incumbent LEC, for example, may fail to provision enough equipment for a competing LEC so that a higher percentage of the competitor's calls are blocked from terminating in the incumbent's region. When a competitor orders trunks in the incumbent's end office, the incumbent may fail to make available the number of trunks requested by competitor, or it may delay installing the trunks in the end office. *Id.*

[475] *See id.*

[476] *See id.* at 14820, para. 243.

[477] *See id.*

[478] *See id.*

another area, or make it a less effective competitor in another area.[479]

206. Bell Atlantic and GTE contend that the current competitiveness in the wireless telecommunications market, indicates that incumbent LECs have neither the ability nor the incentive to discriminate against rivals that rely on the incumbent LECs in order to provision these services.[480] We disagree.[481] An incumbent that weakens a competitive carrier's chance of providing competitive local exchange service in one region weakens that carrier's chances of doing so in other areas as well, due to economies of scale and scope.[482] The merged entity will be able to internalize the external effects of discriminatory conduct. Because of the possibility of internalizing such spillover effects, the incentive for the combined entity to discriminate against competitors providing retail local exchange services in particular areas within the combined region will be greater than the incentive for each company acting as a single entity.[483]

207. Many of the conditions proposed by Bell Atlantic and GTE, and adopted today, address the concerns created by the public interest harms that are concomitant with this merger. For example, the conditions regarding performance measures, OSS reform, and collocation should constrain substantially the merged entity's ability to engage in discrimination against rival local exchange providers. The nexus between the aforementioned conditions and harms mitigates the damage caused by the merger and bolsters the competitive landscape in the merged entity's region.

d. Conclusion

208. For the reasons discussed above, we conclude that, as a result of the merger, the post-merger Bell Atlantic/GTE will have an increased ability and incentive to discriminate against rival providers of advanced services, and particularly new types of advanced services, in the combined region. We also conclude that the combined entity will have an increased incentive and ability to discriminate against rival providers of interexchange services, local services, and bundled local and long distance services. Although the Commission issues rules to prevent discrimination, and will continue to do so, it is impossible for the Commission to foresee every possible type of discrimination, especially with evolving technologies; therefore, we cannot rely on a regulatory solution to address unforeseeable competitive harms that may arise as

---

[479] *See id.*

[480] Bell Atlantic/GTE Dec. 23, 1998 Joint Reply, Arrow Decl. at 23-25.

[481] *See* Sprint Apr. 2, 1999 *Ex Parte* Letter, Hayes, Jayaratne, and Katz Report at 21 (stating that incumbent LECs "have attempted to degrade the quality of interconnection facilities provided to their local cellular competitor," and citing that "it is clearly incorrect to assert there is no evidence of exclusionary behavior by ILECs in cellular markets. On the contrary, the history of cellular competition, like the history of intraLATA competition, shows that ILECs will work hard to prevent entry when they can capture the benefits of doing so.").

[482] *See SBC/Ameritech Order,* 14 FCC Rcd at 14821, para. 244.

[483] *See* Sprint Nov. 23, 1998 Petition at 32 (noting that by internalizing the anticompetitive spillover benefits the merger makes discrimination more profitable and thus more likely); *see also See SBC/Ameritech Order*, 14 FCC Rcd at 14821, para. 244.

a result of the merger. In this Order, we adopt a number of conditions that guard specifically against the discrimination harms identified above, without imposing cumbersome, detailed regulatory oversight.

VII. ANALYSIS OF PUBLIC INTEREST BENEFITS

A. Background

209. In addition to assessing the probable public interest harms of the proposed merger, we also must consider whether the merger is likely to generate redeeming public interest benefits.[484] In doing so, we ask whether the merged entity is likely to pursue business strategies resulting in demonstrable and verifiable benefits to consumers that could not be pursued but for the merger. Public interest benefits also include any cost saving efficiencies arising from the merger if such efficiencies are achievable only as a result of the merger, are sufficiently likely and verifiable, and are not deemed the result of anti-competitive reductions in output or increases in price.[485] Finally, merger specific benefits may also include beneficial conditions proffered by the Applicants or other parties or imposed by the Commission.

210. As detailed above, we conclude in this Order that the proposed merger of Bell Atlantic and GTE is likely to result in substantial harms to the public interest. In considering whether the overall effect of the merger is nevertheless to advance the public interest, we employ a balancing process that weighs probable public interest harms against probable public interest benefits. Applicants can therefore carry their burden of demonstrating that the proposed transaction is in the public interest under the Communications Act only if the transaction on balance will enhance and promote the public interest. As the harms to the public interest become greater and more certain, the degree and certainty of the public interest benefits must also increase commensurately in order for us to find that the transaction on balance serves the public interest.[486] This sliding scale approach requires that where, as here, potential harms are indeed both substantial and likely, the Applicants' demonstration of asserted benefits also must reveal a higher degree of magnitude and likelihood than we would otherwise demand.

211. Applicants assert that the proposed merger will provide public interest benefits that are sufficient to satisfy our public interest balancing test.[487] To satisfy their burden, the Applicants must demonstrate that their merger is a reasonably necessary means to enable them to achieve the asserted benefits, *i.e.*, that the benefits are specific to the merger.[488] Should the Applicants be able to pursue the strategies identified as resulting in public interest benefits

---

[484] *SBC/Ameritech Order*, 14 FCC Rcd at 14825, para. 255; *AT&T/TCI Order*, 14 FCC Rcd at 3168, para 13; *MCI/WorldCom Order*, 13 FCC Rcd at 18134-35, para. 194.

[485] *1992 Horizontal Merger Guidelines* at 30.

[486] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20063, para. 157.

[487] Bell Atlantic/GTE Jan. 27, 2000 Supplemental Filing at 2.

[488] *See SBC/Ameritech Order*, 14 FCC Rcd at 14829, para. 267.